

REPORT ON DOES MACROECONOMICS NEED MICROECONOMIC FOUNDATIONS? By S da Silva.

This is a lively and interesting piece, and I happily recommend its acceptance. It will surely stimulate debate. It is forceful and well written, though possibly quite not as fair as it might be to the exponents of the "macro needs microfoundations" school.

My take on the Lucas Critique is that it could still apply if macroeconomics had other (possibly neurophysical) foundations. For me, what it says is that what agents do when government does (or is thought to do)  $x$  can't tell us how they'd act if were known to do  $y$  - and importantly that impressions gleaned from the former are silent on whether  $y$  might be a superior set of policies to  $x$ . I believe this is true, and holds whatever story one has about private sector behaviour, except those that hypothesize, unreasonably, that government's actions are completely neutral. If your actions were influenced by the pollen count, or by the position of Jupiter in the sky, and not by traditional optimizing, that wouldn't preclude the possibility that your awareness of what government is doing mightn't matter too.

DSGE models (eg New Keynesian micro-based models) have many weak points, it is true. But I would be more inclined to attack their information assumptions, at least as much as the "microfoundations". For many reasons: asymmetric information issues (what about lemons, banks, moral hazard?); issues of disparate information sets (Morris-Shin models); learning issues (Evans-Honkapohja and Sargent); and the other problems that emerge once you depart from the seductive but oversimplified distinction between known (linear?) relationships on the one side, and i.i.d. shocks on the other. Sargent's 2008 AER presidential address paper is a must-refer-to in that last context.

Then there is the standard philosophical sceptic's reply to any assertions that observable brain activity describes mental states and processes: how do you know that? You can't possibly prove that! So da Silva's preferred alternative to traditional micro optimizing is going to be a hard thing to prove. A related point is that an optimizing approach is almost impossible to argue against, as "utility" can encompass externalities, decision taking and information-gathering costs, imitation and much else (notice for example the empirical success of the external habits term in micro-based consumption models).

Bob Solow is said to have once said "The microfoundations of macro might be iffy, but what really scares me is the absence of proper macrofoundations in micro". How telling; how true! So much micro is very partial equilibrium, sometimes behind the veil of pseudo-generality offered, say, by things like quasi-linear utility functions. But it goes much deeper than that. What sort of property rights people have; what determines things like power weights in Nash cooperation, and Coase's boundaries between transactions and in-house activity; family ties and other social relationships; feedbacks and interactions with unmodelled outsiders; the typically crude treatment of time.

Da Silva has some fine insights and some polemical sideswipes at orthodoxy, not along Solow's lines, perhaps, but well worth reading nonetheless.